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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JANUARY 16, 2003

APPLICATION OF

VIRGINIA GAS STORAGE COMPANY

CASE NO. PUE-2001-00358

For an Annual
Informational Filing

ORDER ADOPTING RECOMMENDATIONS
AND DISMISSING PROCEEDINGS

In its January 28, 2002, Order, the State Corporation Commission ("Commission") directed Virginia Gas Storage Company ("VGSC" or the "Company") to file its 2001 Annual Informational Filing ("AIF") by no later than May 31, 2002. In the same Order, the Commission authorized VGSC to use the test period January 1, 2001, through September 30, 2001, for all of its AIF Schedules with the exception of Schedules 9, 10, and 12. The Commission directed the Company to file Schedules 9, 10, and 12, using the twelve months ending September 30, 2001, as the test year for these Schedules, by no later than May 31, 2002.

On May 10, 2002, the Commission granted VGSC's request for a waiver of the portions of Rule 20 VAC 5-200-30 A 9 of the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings ("Rate Case Rules") requiring the filing of Schedules 9 through 14, and the part of Schedule

21 (Workpapers for Earnings Test and Ratemaking Adjustments) relating to the omitted Schedules.

On June 7, 2002, VGSC, by counsel, filed a motion requesting that its AIF delivered to the Commission on June 5, 2002, be accepted out of time. VGSC advised that it was unable to file its AIF on May 31, 2002, because of the extenuating family circumstances experienced by its regulatory compliance officer. VGSC represented in its motion that the Staff did not oppose the Company's request.

On June 14, 2002, the Commission issued its Order and granted VGSC's request to receive the Company's AIF out of time, subject to a further determination concerning the completeness of the documents accompanying VGSC's AIF.

The Company's application was determined to be complete on July 11, 2002.

On December 11, 2002, the Staff filed its Report on the captioned application. This Report included a financial and accounting analysis. Staff noted in its Report that it employed a 11.5% return on equity for illustrative purposes. It explained that in VGSC's application for a certificate of public convenience and necessity for a storage facility, the Company was not a going concern. Because actual operating data was not available, the Company's application was based on rates derived from estimates of revenues and costs. VGSC received authority

from the Commission to provide gas storage service on the basis of the rates filed in its certificate application rather than on a specified return on equity range.

The Staff also explained that it used the consolidated capital structure of NUI Corporation ("NUI") in its Report because NUI is the ultimate source of any market capital available to VGSC. The Staff commented that it generally supports the use of the capital structure of the entity that raises capital on behalf of a utility company's operations. Prior to NUI's acquisition of Virginia Gas Company ("VGC") and VGSC, VGC was the entity whose capital structure Staff used for ratemaking purposes. After NUI's acquisition of VGC and VGSC, NUI became the entity that accessed capital markets to supply capital to VGSC. Consistent with the change in ownership and the Staff's general position regarding capital structures, Staff used NUI's consolidated capital structure for purposes of the Report. NUI's consolidated ratemaking capital structure has an equity ratio of 38.59% and produces a cost of capital of 7.69% for the test year. Staff reported that NUI's capital structure was not significantly different from the consolidated VGC capital structure, which has an equity ratio of 36.88% and produces and overall cost of capital of 7.56%. Staff requested that VGSC file Schedules 1, 2, and 3, required by the Rules Case Rules in any future AIF in accordance with the Rate Case Rules

by including information for the test year and the four prior fiscal years for VGSC and NUI.

In its accounting analysis, the Staff observed there was a disparity between VGSC's filed nine-month total company return on common equity of 6.58% and VGSC's filed jurisdictional return on common equity of 17.78%. That disparity prompted Staff to examine the Company's jurisdictional allocation methodology, as well as VGSC's pricing for service closely. According to Staff, VGSC has always allocated expenses and rate base on contracted volumes, implying that the level of contracted terms is what drives the Company's expenses. To investigate the issue further, Staff recommended that the Commission direct VGSC to conduct a full review of its jurisdictional methodology and to report its findings in the Company's next AIF filing.

Staff noted that VGSC has received approval from the Commission in Case No. PUA-2001-00041, regarding the allocation of common costs and facilities among VGSC's affiliates. With the allocation of the operation and maintenance and facility-related expenses, VGSC's fully adjusted return on common equity would have been 14.20%, based on nine months of earnings. Since the approval of the affiliate application occurred on September 6, 2002, in the last month of the pro forma period examined by Staff, the Staff made no test period ratemaking adjustment to allocate costs among VGSC and its affiliates.

Staff further explained that no costs originating at NUI have been allocated to its regulated subsidiaries and, at the time Staff concluded its Report, there was no affiliate agreement on file with the Commission concerning allocations of common costs from NUI to the regulated subsidiaries. Thus, no allocations from NUI were considered in Staff's accounting analysis.

Additionally, Staff reported that Atmos Energy Corporation ("Atmos") currently has a contract with VGSC for 180,000 therms of gas storage at the Company's Early Grove Storage Facility. Atmos and its affiliate, Woodward Marketing, L.L.C. ("Woodward"), have received approval from the Commission to take gas storage services for Atmos through Virginia Gas Pipeline Company's ("VGPC's") Saltville Storage Facility effective May 1, 2003. This arrangement would replace the current storage agreement for Atmos that uses VGSC's Early Grove Storage Facility. Staff commented that these circumstances could affect VGSC's earnings. Staff, therefore, recommended that VGSC be directed to report to Staff on the status of Atmos' storage arrangements as well as the impact of those arrangements on VGSC's cost of service as part of the Company's next AIF or rate proceeding.

Staff concluded that the results of the nine-month test period ending September 30, 2001, were not directly comparable to the prior twelve-month periods ending December 31, analyzed

by Staff. Because of a number of unresolved circumstances, e.g., the change in the Atmos contract for storage, the Staff proposed that no action be taken regarding VGSC's rates until after consideration of the Company's next AIF.

On January 7, 2003, VGSC, by counsel, filed a letter advising that VGSC did not intend to file a response to the Staff's December 11, 2002, Report.

NOW UPON CONSIDERATION of the Company's application, the December 11, 2002, Staff Report, and the applicable statutes, the Commission is of the opinion and finds that the Staff's recommendations found in the December 11, 2002, Staff Report should be adopted and that the captioned application should be dismissed from the Commission's docket of active proceedings.

Accordingly, IT IS ORDERED THAT:

(1) Consistent with the findings made herein, the recommendations set out in the Staff's December 11, 2002, Report are hereby adopted.

(2) VGSC shall file Schedules 1, 2, and 3, in any future AIF consistent with the Commission's Rate Case Rules by including information for the test year and the four prior fiscal years.

(3) VGSC shall report to the Staff on the status of its provision of storage services to Atmos and the impact of Atmos' receipt of storage services from the Saltville Storage Facility

rather than VGSC's Early Grove Facility on VGSC's cost of service in the Company's next AIF or rate proceeding.

(4) With regard to VGSC's jurisdictional allocation methodology and storage pricing methodology, VGSC shall conduct a full review of its jurisdictional allocation methodology and report the results of such review in the Company's next AIF.

(5) There being nothing further to be done in this proceeding, this application shall be dismissed from the Commission's docket of active proceedings, and the papers filed herein placed in the Commission's files for ended causes.